

11 U.S.C. § 522(f)(1)(A)
11 U.S.C. § 1322(b)(2)
ORS 86.735(4)
ORS 86.715
ORS 88.010
ORS 88.040
ORS 86.770(2)

In re Daraee, Case No. 301-36459-tmb13

4/11/02

TMB

Pub

Prior to the bankruptcy filing Portland Teacher's Credit Union, which held two promissory notes secured by deeds of trust on the debtor's residence, filed suit and obtained judgment on the notes. The judgment, which was obtained in Washington County and registered in Clackamas County, created a judgment lien against both the debtor's residence and a rental property.

In her plan the debtor sought to avoid the Credit Union's judicial lien under § 522(f)(1)(A). The Credit Union objected to confirmation of the debtor's plan, arguing that § 1322(b)(2) prohibited the debtor from modifying its rights under the deeds of trust. The debtor disagreed. She contended that the Credit Union had waived its deeds of trust by suing on the underlying promissory notes and that therefore the Credit Union had no rights under § 1322(b)(2).

The Credit Union conceded that ORS 86.735(4) prohibited it from foreclosing its trust deeds by advertisement and sale. It contended, however, that it could, under ORS 86.715, treat those trust deeds as mortgages and seek judicial foreclosure under ORS 88.010.

The court disagreed. It noted that under Oregon law the holder of a security interest in real property can foreclose on its collateral and thereafter sue on the note to collect any deficiency unless the security agreement is a purchase money mortgage or a residential deed of trust in which case the creditor is prohibited from seeking a deficiency judgment. It also noted that although no Oregon statute specifically prohibits a creditor from avoiding the restriction on collection of deficiencies by suing first on the note and then foreclosing its security interest, that Oregon law has consistently held that if a purchase money mortgagee obtains a judgment on a mortgage debt he loses his mortgage lien. The court, citing Judge Radcliffe's holding in Knight v Boese (In re Knight), Adversary Case No. 91-6190-R (Bankr. D. Or. 1992) found that this doctrine, referred to as an election of remedies, was designed to prevent a holder of a purchase money mortgage or residential trust deed from doing indirectly what the anti-deficiency statutes prohibit him from doing directly, i.e. collecting a deficiency on foreclosure of the mortgage or trust deed. The court therefore concluded that the Credit Union had waived its

rights under the trust deeds by suing on the underlying notes, leaving the Credit Union with its judgment lien as its only security.

The court went on to find that the § 1322(b)(2) did not prohibit the debtor from avoiding the Credit Union's judgment lien. It noted first that the lien attached to the debtor's rental property as well as her residential property, taking it outside the purview of § 1322(b)(2). It further noted that § 1322(b)(2) would not apply to prevent modification of the Credit Union's rights under the judicial lien, even if it had attached only to the debtor's residential property, because a judicial lien is not a consensual lien and therefore not a security interest subject to protection under § 1322(b)(2). The court therefore confirmed the debtor's proposed plan over the creditor's objection.

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF OREGON

In re:)	Case No. 301-36459-tmb13
KAMIAR DARAEI,)	MEMORANDUM OPINION
Debtor.)	

This matter came before the court on the Objection of the Portland Teacher’s Credit Union (hereinafter “PTCU”) to confirmation of the debtors’ proposed Chapter 13 plan. A hearing on this matter was held on February 7, 2002. The debtors were represented by Jason Wilson-Aguilar. PTCU was represented by Peter McCord. Thereafter, I took these matters under advisement.

I have reviewed my notes, the exhibits, and the pleadings and other submissions in the file. I also have read applicable legal authorities, both as cited to me and as located through my own research. I have considered carefully the oral testimony and arguments presented and have read counsel's submissions in detail. The following findings of fact and legal conclusions constitute the court's findings under Federal Rule of Civil Procedure 52(a), applicable in this proceeding under Federal Rule of Bankruptcy Procedure 9014.

1 **FACTS**

2 The facts are not in dispute. On or about February 9, 1996 the debtors borrowed
3 \$17,129 from PTCU under a line of credit agreement. This debt was secured by a Deed of Trust
4 dated February 9, 1996, recorded February 12, 1996, as Document No. 96011889 in the official
5 records of Washington County, Oregon, in which the Debtors were the Grantors and PTCU was the
6 Beneficiary. ("February Trust Deed".) The February Trust Deed encumbered the Debtors'
7 residential real property located at 13403 SW Clearview Way, Tigard , Oregon 97223.

8 On or about November 21, 1996 the debtors borrowed an additional \$25,000 from
9 PTCU under a home equity loan agreement. This debt was secured by a second Deed of Trust dated
10 November 21, 1996, recorded November 26, 1996, as Document No. 96105499 in the official records
11 of Washington County, Oregon ("the November Trust Deed"). The November Trust Deed also
12 encumbered the Clearview Way property.

13 Both the February Trust Deed and the November Trust Deed contained language
14 providing that upon default PTCU could:

15 " . . . exercise any one or more of the following rights and
16 remedies, in addition to any other rights or remedies provided
by law:

17 (a) With respect to all or any part of the Real Property , the
18 Trustee shall have the right to foreclose by notice and sale and
[PTCU] shall have the right to foreclose by judicial foreclosure,
19 in either case in accordance with and to the full extent provided
by applicable law." Trust Deeds, ¶14.1

20 Additionally, the Trust Deeds contained a provision regarding election of remedies as follows:

21 " . . . Election by [PTCU] to pursue any remedy shall not
22 exclude pursuit of any other remedy, and an election to make
expenditures or take action to perform an obligation of Grantor
23 under this Deed of Trust after failure of Grantor to perform shall
not affect [PTCU]'s right to take actions on the indebtedness
24 and exercise its remedies under this Deed of Trust." Trust
Deeds, ¶ 4.4
25
26

1 The debtors subsequently defaulted on their obligations to PTCU under the line of
2 credit and home equity loan agreements. PTCU then filed a suit against the debtors in Washington
3 County Circuit Court seeking a judgment in the amount due on the notes secured by the deeds of
4 trust. On July 21, 2000 the Washington County Circuit Court entered judgment against the debtors
5 and in favor of PTCU in the amount of \$43,700.02 plus costs and attorney fees in the amount of
6 \$4,966.00 (“PTCU Judgment”). The PTCU Judgment constituted a lien on all of the debtors’ real
7 property located in Washington County. In addition, on July 25, 2000, PTCU recorded a Lien
8 Record Abstract in Clackamas County where the PTCU Judgment became a lien on all of the
9 Debtors’ real property located in that county. The Debtors made some payments toward the
10 judgment held by PTCU but did not wholly satisfy it.

11 On June 28, 2001, the Debtors filed their Chapter 13 bankruptcy petition. Their
12 schedules indicate that they own two pieces of real property, their residence located on Clearview
13 Way which they valued at \$360,000, and a rental property located at 19230 Bryant Rd., Lake Oswego
14 Oregon which they valued at \$218,440.

15 The Clearview Way property is encumbered by a first mortgage or trust deed lien
16 in favor of Washington Mutual in the amount of \$279,000 and a Washington County real property tax
17 lien in the amount of \$3,808.18. In addition, the schedules indicate it is encumbered by the judgment
18 liens held by PTCU and a judgment lien in favor of Wells Fargo. The schedules further indicate that
19 the residential property is encumbered by a deed of trust in favor of PTCU but that it is “disputed”
20 and that it is “Debtor’s portion (sic) is Trust Deed merged into judgment.”

21 The Bryant Rd. property is encumbered by a first mortgage or trust deed lien in
22 favor of Mainlander Service Corp in the amount of \$206,250 and a Clackamas County real property
23 tax lien in the amount of \$2,569.18. In addition, the schedules reflect it is encumbered by the PTCU
24 judgment lien as well as a judgment lien in favor of Wells Fargo Bank.

1 The Debtors' original Chapter 13 plan is dated July 19, 2001. Both PTCU and
2 Wells Fargo were listed in paragraph 2(b). However, the plan states that there was no equity in the
3 properties to which either PTCU's or Wells Fargo's judgment liens could attach and that, as a
4 consequence, their claims would be treated as wholly unsecured. The plan further provided that
5 "Upon entry of discharge the judgment liens of Wells Fargo and PTCU shall be deemed extinguished
6 and satisfied." The plan further provided that Wells Fargo's and PTCU's judgment liens against the
7 debtors' residential property would be avoided under § 522(f)(1)(A).

8 PTCU objected to confirmation of the debtor's proposed plan. It argued that in
9 addition to the judgment lien recognized by the debtors, it was also a secured creditor by virtue of the
10 two deeds of trust it held against the Clearview Way property. In addition it argued that its rights
11 were not subject to modification because its claim was secured only by the debtors' principal
12 residence. Finally, it argued that its trust deed secured claim was superior to any homestead
13 exemption claimed by the debtors and therefore could not be avoided under § 522.

14 The Debtors filed their first amended Chapter 13 plan dated October 17, 2001, on
15 October 18, 2001. This plan increased the total amount of payments that the debtors were to make
16 over the life of the plan. However, it did not change the manner in which PTCU's claim was treated.
17 Creditor First Select was substituted for Wells Fargo Bank as a judgment lien creditor. On October
18 24, 2001, PTCU filed an objection to the amended plan in which it incorporated its objections to the
19 original plan.

20 **DISCUSSION**

21 The debtors dispute PTCU's characterization of its security interests. The Debtors
22 contend that by suing on the notes secured by the deeds of trust, PTCU waived its rights under the
23 deeds of trust and therefore has no security for its claim except its judicial liens. In support of this
24 contention the debtors cite O.R.S. 86.735(4) and In re Morrison, Case No. 300-31640-tmb13 (Bankr.
25 D. OR. 2000).

1 O.R.S. 86.735(4) states that:

2 “The trustee may foreclose a trust deed by advertisement and
3 sale in the manner provided in ORS 86.740 to 86.755 if: . . .

4 (4) No action has been instituted to recover the debt or any part
5 of it then remaining secured by the trust deed, or, if such action
6 has been instituted, the action has been dismissed”

7 In Morrison, this court held that a creditor had elected its remedies by suing
8 on a promissory note underlying its deed of trust and thus lost its deed of trust lien. I based this
9 decision on the fact that the loan documents entered into by the parties in Morrison prohibited the
10 creditor from pursuing more than one remedy for the debtor’s breach. However, I also noted that
11 ORS 86.735(4) “suggests that once the whole note has been sued upon, no further action can be
12 brought.”

13 PTCU argues that Morrison is distinguishable on its face because the deed of trust
14 in that case prohibited the creditor from pursuing more than one of the remedies provided for in the
15 deed of trust whereas the trust deeds at issue in this case permits it to “exercise any one or more” of
16 the remedies provided for in the trust deeds (emphasis added). Further, while it concedes that it is
17 prohibited by ORS 86.735(4) from foreclosing its trust deeds by advertisement and sale, it contends
18 that it is entitled to treat the trust deeds as mortgages and seek judicial foreclosure under ORS 88.010
19 et. seq.

20 ORS 86.715 states:

21 “A trust deed is deemed to be a mortgage on real property and is
22 subject to all laws relating to mortgages on real property except
23 to the extent that such laws are inconsistent with the provisions
24 of ORS 86.705 to 86.795, in which event the provisions of ORS
25 86.705 to 86.795 shall control.”

26 ORS 88.010 provides that a mortgage shall be foreclosed by suit subject, however,
to ORS 88.040 which provides:

“During the pendency of an action for the recovery of a debt
secured by any lien mentioned in ORS 88.010, a suit cannot be
maintained for foreclosure of the lien, nor thereafter, unless

1 judgment is given in such action that the plaintiff recover the
2 debt or some part thereof, and an execution thereon against the
3 property of the debtor is returned unsatisfied in whole or in
4 part.”

5 PTCU contends that the language of ORS 88.040 clearly recognizes that a creditor
6 has the right to bring an action on the note underlying a trust deed, execute on that judgment, and, if
7 it is unable to satisfy the judgment by execution, still foreclose on its collateral.

8 The Debtors argue that PTCU’s reliance on ORS 86.715 is misplaced. They note
9 that ORS 86.715 provides that a trust deed shall be subject to mortgage law “except to the extent that
10 such laws are inconsistent with the provisions of ORS 86.705 to 86.795” Here they argue, allowing
11 PTCU to proceed with judicial foreclosure of the trust deeds under mortgage law would be
12 inconsistent with the provisions of ORS 86.770(2)(b) and is, therefore, not permitted by ORS 86.715.

13 ORS 86.770(2) provides:

14 “. . . no other or further action shall be brought, nor judgment entered for
15 any deficiency, against the grantor, or the grantor’s successor in interest,
16 if any, on the note, bond, or other obligation secured by the trust deed or
17 against any other person obligated on such note, bond or other obligation
18 after a sale is made:

19 (a) By a trustee under ORS 86.705 to 86.795; or

20 (b) Under a judicial foreclosure of a residential trust deed.”

21 PTCU agrees with the debtor’s contention that the trust deeds at issue are
22 residential trust deeds and that it could not judicially foreclose those trust deeds and then obtain a
23 deficiency judgment on them. It argues, however, that under ORS 86.770(2)(b) the bar prohibiting a
24 creditor from obtaining a deficiency judgment does not become operative until after a foreclosure
25 sale. Here, it argues, since no foreclosure sale has occurred, the provisions of ORS 86.770(2) do not
26 come into play. Consequently, it contends, it may maintain judicial foreclosures of its trust deeds
without violating the provision of that statute.

1 The statutes cited by the parties clearly state that a creditor who forecloses a
2 residential deed of trust, either by advertisement and sale or through judicial foreclosure, may not
3 thereafter obtain a deficiency judgment against the obligor on the underlying obligation. However,
4 none of these statutes directly address the issue of whether a creditor who holds a note secured by a
5 residential deed of trust may sue on the note and then foreclose on its deed of trust. I must, therefore,
6 look to case law for the answer to that question.

7 Under Oregon law, a holder of a security interest in real property, whether a
8 mortgage or a deed of trust, may judicially foreclose on its collateral and, thereafter, sue on the note
9 to collect any deficiency owing unless the security agreement is a purchase money mortgage or a
10 residential deed of trust. In such cases the creditor is prohibited from seeking a deficiency from the
11 grantor by statute. ORS 86.770(2) (Residential Trust Deed) and 88.070 (Purchase Money Mortgage).

12 No statute specifically prohibits a creditor from avoiding the restriction on suing to
13 collect deficiencies for purchase money mortgages and residential deeds of trust by first suing on the
14 notes, executing on that judgment and thereafter foreclosing its security interest. However, Oregon
15 case law has consistently held that “If the purchase money mortgagee elects to foreclose the
16 mortgage, he is barred from bringing an action on the mortgage debt, or he may obtain a judgment on
17 the mortgage debt, in which case he loses his mortgage lien.” Banteir v. Harrison, 259 Or. 182, 485
18 P.2d 1073, 1075 (1971). See also, Ward v. Beem Corporation, 249 Or. 204, 209, 437 P.2d 483
19 (1968) (“ . . . purchase money mortgagee has an election to either foreclose his mortgage, in which
20 case he is barred from bringing an action on the mortgage debt, or to obtain a judgment on the
21 mortgage debt, in which case he loses his mortgage lien.”) Beckson v. Frank, 97 Or. App. 347,
22 351(1989) (“a trust deed beneficiary may elect to sue on the note and thereby waive his priority and
23 security, or he may foreclose on the security and waive his right to collect a deficiency.”)

24 In Knight v Boese, (In re Knight), Adversary Case No. 91-6190-R (Bankr. D. Or.
25 1992), Judge Radcliffe noted that the doctrine of election of remedies, whereby a creditor who elects
26 to sue on a note loses his mortgage or trust deed lien, was developed by the Supreme Court of Oregon

1 “as a necessary corollary to the anti-deficiency statutes [such as ORS 86.770(2).]” He notes that
2 under this doctrine:

3 “a purchase money mortgagee or trust deed beneficiary has an
4 election upon default. It may either elect to (1) foreclose upon
5 the property encumbered by its mortgage or trust deed in the
6 manner provided by law, or in the alternative, it may (2) bring
7 an action at law against the parties personally liable for the debt
8 secured by the mortgage or trust deed. Once a remedy has been
9 elected, the creditor is barred from pursuing the other remedy.”

10 He goes on to note:

11 “One obvious reason for the development of [the doctrine of
12 election of remedies] lies in the rationale that the mortgagee or
13 trust deed beneficiary should be prevented from doing indirectly
14 what the anti-deficiency statutes prohibit, directly. In other
15 words, if the statutes prohibit the obtaining of a deficiency after
16 foreclosure, a creditor should not be able to obtain a judgment,
17 execute thereon and then collect the deficiency, if any, by way
18 of foreclosure. This would permit a creditor to obtain a
19 deficiency judgment so long as the creditor elected to sue the
20 parties personally liable on its debt first and to execute upon any
21 judgment obtained prior to attempting foreclosure on the
22 property subject to a purchase money mortgage or trust deed.”

23 I agree with Judge Radcliffe’s well reasoned opinion in Knight and find that, under
24 the doctrine of election of remedies, a creditor who elects to sue on a note secured by a residential
25 deed of trust and obtains judgment on that suit thereby waives its trust deed lien. Accordingly, I find
26 that PTCU does not hold enforceable trust deeds against the Debtor’s Crestview Way property.
Rather it has judgment liens which fall in priority after the Debtors’ homestead exemption of \$33,000
pursuant to ORS 23.240. The question then becomes whether PTCU’s judgment lien can be stripped
away pursuant to 11 U.S.C. § 522(f)(1)(A).

PTCU argues that the provisions of 11 U.S.C. § 1322(b)(2) prohibit the Debtors
from modifying its rights as its only security is the Debtors’ “principal residence.” Obviously, this is
innacurate as PTCU has a judgment lien on both the residence in Washington County and the rental
property in Clackamas County. 11 U.S.C. § 1322(b)(2) is not applicable. Further, § 1322(b)(2) only
prohibits a debtor from modifying the rights of holders of secured claims if those claims are secured

1 by a “security interest” in the debtor’s principal residence. The term security interest is defined by
2 the Bankruptcy Code as a “lien created by agreement.” 11 U.S.C. § 101(51). A judicial lien is not
3 created by agreement. Thus, § 1322(b)(2) would be inapplicable even if PTCU’s judgment lien
4 attached only to the debtor’s principal residence.

5 No evidence was presented as to the value of the real property. Therefore, I will
6 use the figures contained in the Debtors’ schedules:

	<u>Residence</u>	<u>Rental Property</u>
7 Value	\$ 360,000.00	\$ 218,440.00
8 Less 7% Cost of Sale	<u>(25,200.00)</u>	<u>(15,290.80)</u>
9	334,800.00	203,149.20
10 Less Real Property Taxes	<u>(3,808.18)</u>	<u>(2,601.70)</u>
11	330,991.82	200,547.50
12 Less First Lien (Claimed Amount by Washington Mutual)	<u>(289,442.12)</u>	(Claimed Amount by Mainlander) <u>202,208.53</u>
13	41,549.70	(1,661.03)
14 Less Homestead Exemption	(33,000.00)	n/a
15 Available Equity for 16 Creditors	\$ <u>8,549.70</u>	\$ <u>None</u>

17 No evidence was presented as to the amount of First Select’s judgment lien nor its priority with
18 respect to PTCU’s judgment lien. It appears there is at least \$8,549.70 of equity to which one or both
19 of these judgments would attach. However, I have insufficient information to make a determination
20 with respect to the priority or amount of the judgment liens. Therefore, I will deny confirmation and
21 allow the Debtors 28 days to file an amended plan.

22
23 TRISH M. BROWN
Bankruptcy Judge

24 cc: Peter C. McCord
25 Jason Wilson-Aguilar
26